Supreme Court of the United States

No. .....

TERM A. D. 1944.

IN THE MATTER

OF

ASSOCIATED GAS AND ELECTRIC COMPANY,
Debtor,

In Proceedings for the Reorganization of a Corporation Pursuant to Chapter X of the Bankruptcy Act.

—o—

IRVING ELIAS, MAX MENACHEN and MICHAEL MOISE, constituting the Protective Committee for the Holders of Convertible Obligations, Due 2002, etc., *et al.*,
Petitioners and Appellants Below,

AGAINST

STANLEY CLARKE, Trustee of ASSOCIATED GAS AND ELECTRIC COMPANY, Debtor, *et al.*,
Respondents and Appellees Below.

Brief in Support of Petition for Writ of Certiorari.

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Opinions Below.

The opinion of the United States Circuit Court of Appeals for the Second District is reported in 143 F. 2d 640. The opinion is also printed in full in the record (R. pp. 324-337).

The opinion of the United States District Court for the Southern District of New York, is reported in 53 F. Supp. 107. The opinion is also printed in full in the Record (R. pp. 271-297).

The opinion and report of the Special Master is printed in full in the Record (R. pp. 196-263).

Jurisdiction.

The jurisdiction of this Court is invoked under Section 24 of the Bankruptcy Act, subdivision (c). A statement of the grounds on which the jurisdiction of this Court is invoked is contained in the petition pursuant to Rule 38 (5) (b), filed herewith (*supra*, pp. 10-13), and petitioners respectfully request that said statement be deemed incorporated in the brief at this point. Judgment was entered in this case on July 14, 1944 (R. p. 337).

Statement of the Case.

The essential facts of the case are presented in the petition filed herewith (*supra*, pp. 2-10) to which petitioners respectfully refer. In the interest of brevity the facts are not repeated here. It will be noted, however, that there are no controverted issues of fact in this case.

Specifications of Error.

1. The Circuit Court of Appeals erred in determining issues not presented in the Record on Appeal and assumed by the District Court in favor of appellants.

2. The Circuit Court of Appeals erred and prejudiced the rights of appellants herein in sanctioning the procedure adopted by the District Court of determining only certain but not all of the issues peraining to the COABs.

3. The Circuit Court of Appeals erred in approving a final District Court Order of Classification of Creditors in bankruptcy which differentiated between original hold-

ers of the Debtor's obligations and transferee holders of the same obligations, and which barred the latter from participating in the Debtor's estate, while permitting the former to participate. The Circuit Court of Appeals erred in failing to hold that this constituted an unequal and discriminatory distribution of an insolvent estate, contrary to the provisions of the Bankruptcy Act, and denied to general creditors the equal protection of the laws granted them by the Federal Constitution.

4. The Circuit Court of Appeals erred in holding the subordination agreement contained in the COABs valid and enforcible in a court of equity and bankruptcy where it was assumed by the District Court and in the Record on Appeal that the subordination agreement in question was obtained without consideration and through fraud and misrepresentation.

5. The Circuit Court of Appeals erred in failing to hold that COABs, which by their terms are not subordinate to any issue of 5½% CICs or CDCs outstanding, are entitled to stand and share on a parity with the CICs and CDCs, who participate in the estate and funds of the Debtor AGECO.

6. The Circuit Court of Appeals erred in failing to hold that the subordination agreement contained in the COABs is inconsistent, ambiguous and therefore void.

7. The Circuit Court of Appeals erred in holding that the New York law is applicable to the rights of all assignees and transferees of COABs irrespective of where such assignments were executed.

8. The Circuit Court of Appeals erred in failing to find that the subordination provisions and terms made the COABs "illusory promises" which gave their holders a cause of action against AGECO as a general creditor.

ARGUMENT.

POINT A.

The Circuit Court of Appeals erred in its procedure and exceeded its jurisdiction.

The procedure adopted by the Circuit Court of Appeals was erroneous in two particulars:

FIRST: The Circuit Court of Appeals erred in approving the procedure of the District Court which determined only certain issues or portions of the Special Master's findings and conclusions of law pertaining to the COABs, and which did not consider all of the issues affecting the COABs. The procedure adopted was both novel and irregular inasmuch as the petitioners-appellants for the COABs filed objections to other findings of fact and conclusions of law in the Special Master's report, which, in addition to the conclusions of law in question, had to also be determined in order to adjudicate fully the status of the COABs in their favor. The District Court passed only upon certain issues pertaining to the COABs and assumed the other issues in the case to be in their favor (843).

A procedure which prejudices the rights of any class of creditors on appeal would concededly be improper. It is conceded by respondents that it was impossible to fully determine the rights of these claims in their favor without an adjudication of all the issues presented, although this would incidentally involve an adjudication of the status of the CDCs and the original holders of COABs, who are participating in a Plan of Compromise and Reorganization of the Debtor. The District Court's opinion that adverse determinations could be made against appellants on certain issues, without consideration of all the issues and the entire record, prejudiced the rights of the appellants who were entitled to have all the substantive issues determined in one appeal on their merits.

It is contended that Rule 42 (b) and Rule 54 (b) of the Federal Rules of Civil Procedure are applicable. It will be noted in the case of *Reeves* v. *Beardall*, 316 U. S. 283, 285, this court distinctly states:

> "That rule, the joinder provisions (see Rules 13, 14, 18, 20) and the provision of Rule 42 which permits the Court to order a separate trial of any separate claim or issue, indicate a 'distinct policy' (*Collins* v. *Metro-Goldwin Pictures Corp., supra*, p. 85) to permit the entry of separate judgments where the claims are 'entirely distinct'."

It is specifically stated that it permits the entry of separate judgments where the claims are *entirely distinct*. It will also be noted that Rule 54(b) states that:

> "The Court in any stage upon the determination of the issues material to a particular claim and all counterclaims arising out of the transaction or occurrence which is the subject matter of the claims, may enter a judgment disposing of such claim. * * *."

It is clearly the intention, therefore, to permit the disposition of a particular claim providing *all* of the *issues* material to this particular claim and arising out of the transaction are disposed of, the claim must be disposed of in its entirety and be entirely distinct from the other claims pending before the Court.

This is not true in the instant case since the Trustees before the Circuit Court of Appeals admitted in their brief, it was not possible to fully determine the rights of these claimants, in their favor, without an adjudication of the status of the CDCs and original holders of COABs. The net effect of this ruling will be as follows:

That after arguing this case on the limited issues before the Circuit Court of Appeals and possibly the Supreme Court of the United States, if the contention of the appellants is upheld it will first become necessary then to go back before the District Court to determine fully the status of the CDCs and original holders of COABs, in which case it may become necessary to again review these other questions before the Circuit Court of Appeals and possibly the Supreme Court of the United States. This procedure is unquestionably prejudicial to the rights of the appellants herein and in effect splits one appeal into several.

It is the right of the appellants to have all issues and questions involving their substantive rights determined by the District Court so that they may be disposed of in one appeal. The procedure followed by the District Court herein was improper and prejudicial to the rights of the appellants herein, particularly where the issues were indivisible as in this case, and the Report of the Special Master was rendered on all the issues.

SECOND: The Circuit Court of Appeals erred and exceeded its jurisdiction by passing upon issues not presented by the record on appeal. The District Court determined that adverse findings could be made against the appellants on certain issues, pertaining only to these appellants, without considering the entire record and without adjudicating the other issues involving the status of the CDCs and the oirginal holders of COABs who participate in the Plan of Compromise and Reorganization of AGECO. This novel procedure accounts for the necessary assumptions made by the District Court in appellants' favor on the other undetermined issues pending before the District Court (R. 843; 897-903). The District Court did not determine the remaining findings and conclusions of the Special Master but assumed that the issues there involved would be resolved in favor of appellants.

The Circuit Court of Appeals recognized the unfairness of this mode of procedure (R. pp. 331-332) and erroneously attempted to remedy it by ruling on all the issues, even those not determined and still pending before the District Court. The Circuit Court of Appeals passed upon the question of the legality and power of a New York corporation to reserve in its bonds an option to convert its bonds into preferred stock upon the fulfilment of certain conditions precedent and, in addition, upon the further question whether the necessary conditions precedent were properly fulfilled by the Debtor prior to the purported exercise of such option. The Circuit Court of Appeals in ruling upon these issues, assumed by the District Court in appellants favor and not presented in the record on appeal, prejudiced the substantive rights of petitioners who contended that the subordination agreement was void as a matter of contract law since it was obtained through fraud and without any additional consideration.

The record on appeal did not contain the evidence necessary for the proper determination of these questions, in view of the fact that these issues were not raised by the District Court order appealed from but were assumed by the District Court in favor of appellants; nor was there any burden on the part of the appellants to introduce such evidence in the record on appeal, since it was the duty of the appellants to exclude from such record any evidence not material or relevant to the issues presented by this appeal. The Circuit Court of Appeals erred in holding "that the record on appeal did not contain all the evidence" and "the Master's finding of fact must be sustained when unopposed by any evidence in the record" where the questions were not presented by the record on appeal. The Circuit Court of Appeals, in reviewing questions on their merits not presented by the record on appeal, basically prejudiced the rights of the appellants and hence so clearly departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

POINT B.

The order of classification, differentiating between original holders of COABs who participate in the debtor's estate and transferee holders of COABs who are barred from participation, is contrary to law, inequitable and discriminatory. If permitted to stand, it will result in an unequal and discriminatory distribution of the insolvent estate. It contravenes the rights of the petitioners under the equal protection clause of the Federal Constitution.

In insolvency proceedings it is established law in the United States that all creditors of the same rank or class participate to the same extent in the funds of the Debtor estate.

Section 65 (a) of the Bankruptcy Act (11 U. S. C. A. 105 [a]) provides:

> "Dividends of an equal percentum shall be declared and paid on all allowed claims except such as have priority or are secured."

The Fifth Amendment to our Federal Constitution has been held under its due process of law provision to guarantee to any person within its jurisdiction the equal protection of the laws.

In *United States* v. *Yount*, 267 Fed. 861, Western District of Pennsylvania, 1920, the government sought to remove a prisoner to another District Court for trial in a prosecution under the Lever Act. The Court ordered the defendant released holding the statute unconstitutional because associations of farmers were unreasonably exempted from the operation of the Act. At page 863 the Court said:

> "It seems reasonably clear that the due process of law provision of the Fifth Amendment is broad

> enough in its scope and purpose to include the 'equal protection of the laws' which no state may deny to any person under the provisions of the Fourteenth."

The effect of the order of classification appealed from is to divide the COABs into two different classes:

Class 1. Holders of COABs Due 2002, Series A and B, which had been issued in exchange for CDCs and which remain in the hands of the persons to whom they were originally issued or their personal representatives. This class participates in the limited funds of the Debtor (or in the Plan of Compromise and Reorganization of the Debtor).

Class 2. Holders of Convertible Obligations Due 2002, Series A and B, which were in the hands of persons other than the original holders of CDCs who had exchanged them for COABs; this class includes transferees of persons who had originally held CDCs or persons who had exchanged them for CCs, old COs or for cash. This class does not participate in the limited funds of the Debtor and has been excluded by the Court order appealed from.

It will be noted that the order of classification not only distinguishes between COABs which have been issued in exchange for CDCs but also differentiates between COABs which had been issued in exchange for CDCs and which remain in the hands of the persons to whom they were originally issued, as distinguished from the class of persons who held these COABs as transferees of persons who had originally held CDCs and exchanged them for COABs. It will be further noted that only the first class participates in the Plan of Reorganization and Compromise of the Debtor. The principal amount of COABs outstanding on January 10, 1940, when the Debtor was adjudicated a bankrupt, was $48,846,284. After the settlement with

Howard C. Hobson and others the Trustees of AGECO acquired and cancelled COABs in the principal amount of $6,756,440, leaving a balance outstanding in the hands of the public in the amount of $42,089,844 (323-324).

On May 31, 1932, there were outstanding in the hands of the public CDCs in the sum of $36,333,539 (306). On January 10, 1940, there were CDCs outstanding which had not been surrendered in the sum of $3,808,527 (333-334). After May of 1932 when AGECO first notified holders of CDCs that AGECO was exercising its option to convert these securities into stock, the bulk of the CDCs in the approximate amount of $30,000,000 to $32,000,000 were exchanged for COABs (751). It will be seen that the bulk of the COABs were originally obtained in exchange for CDCs. The CDCs, as distinguished from the COABs, contained no subordination agreement. The Special Master found in his report that CDCs which were valid and outstanding were unsubordinated general debt of AGECO and entitled to participate as such in the funds of AGECO (788).

Denial of Equal Protection of the Laws.

The fundamental principle of our insolvency laws is equality of treatment of all, and proportionate distribution to all having claims against the limited fund. The principle that equality is equity is especially applicable to the settlement of insolvent estates.

The order of classification, distinguishing particularly between original holders of COABs who had exchanged them for CDCs on one hand, and transferees of such holders, on the other, which order was approved by the Circuit Court of Appeals, conflicts with the Bankruptcy Act and contravenes the equal protection clause of the Federal Constitution.

The decisions of this Court uniformly hold that the law aims at equality in its application and that the Fed-

eral Constitution and Bankruptcy Act were designed to prevent undue favor to one at the expense of another. In *Truax* v. *Corrigan,* 257 U. S. 312, 331, this Court, in discussing the guarantee of equal protection, analogously set forth in the Fourteenth Amendment, said:

> "Our whole system of law is predicated on the general fundamental principle of equality of application of the law * * *. The guaranty (of equal protection) was aimed at undue favor and individual or class privilege, on the one hand, and at hostile discrimination or the oppression of inequality, on the other. It sought an equality of treatment of all persons." (Parenthetical matter added.)

Similarly, in *Louisville etc. R. Co.* v. *Bosworth,* 230 Fed. 191, 207, the Court said:

> "And what is it then to deny the equal protection of those laws? It is to refuse to grant or to withhold equal treatment in conferring or securing rights or in imposing or exacting performance of duties. It is to treat differently or to discriminate in so doing. And it may be said to include an intention in doing what is done, to treat differently or to discriminate. But, if such is the natural consequence of what is done, it is to be taken that there was an intention to treat differently or to discriminate. One is always held to intend that which is the natural consequence of what he does. The essence of the Fourteenth Amendment therefore is to forbid discrimination and to require equal treatment on the part of such department of the state in the exercise of its particular function, and its effect is to empower and to make it incumbent on the courts, state and federal, to prevent discrimination and to secure equal treatment."

Any distinction, particularly between the original holders and other holders (transferees, etc.) of COABs which were exchanged for CDCs, is inequitable and discriminatory because it would present an unmerited windfall to the other security holders of the Debtor.

The Special Master found that prior to the act of conversion by AGECO in 1932, all CDC holders were unsubordinated general creditors of AGECO (788).

Assuming for the purposes of this brief, as the District Court necessarily did, that the conversion privilege was illegally or improperly exercised, what was the effect of the alleged act of conversion? What could it actually have accomplished?

The answer must be that if the power to act did not exist, the alleged exercise of the act accomplished nothing. The net result of the alleged act then is a nullity and the certificate holders had the same rights as previously.

What were these rights? One consisted of conveying a right to share in the funds of the estate, whatever they were, as a general unsubordinated creditor.

The CDC holders were entitled to have a portion of the estate and a share of its funds which could have been mathematically ascertained and the other security holders were entitled to have a portion of the estate and a share of its funds which could have also been mathematically ascertained.

Why should only the original holder of the COAB, obtained in exchange for a CDC, receive a share, but not his transferee?

Why subsequently should the estate, or, better still, the other security holders whose share was also fixed, be enriched by the exercise of an act which was void and which could have no legal effect?

Prior to the alleged act of conversion, the share of each CDC holder in the estate of AGECO was fixed and could be mathematically ascertained. So was a share of every other security holder in this fund.

Therefore, the other security holders are being deprived of nothing if *all* the holders of COAB's which were exchanged for CDC's participate in the funds of the estate. On the other hand, if all the holders of COAB's which were exchanged for CDC's do not participate, the share of the other security holders of AGECO are to that extent enlarged and enriched.

This result in itself is clearly inequitable and presents a windfall to one class of security holders at the unmerited expense of another class. The law has never been so unreasonable.

The test should not be who is the person who holds the COAB, but the certificate itself. What does it actually represent, to wit, was it originally exchanged for a CDC?

It is pertinent to note that the undersigned found no other case in bankruptcy reorganization practice where such a distinction was made as sought herein between original holders and transferee holders of a security certificate which was exchanged for another.

Indeed, if this distinction is applied to COAB's, it should be applied to all the other securities of AGECO. It is a well known fact that most of the securities of AGECO, particularly the Fixed Interest Debentures, have been sold in the open market many times and with few exceptions are not in the hands of the original holders.

To increase the equity of such security holders at the unmerited expense of another class of creditors is a windfall which has no justification in law or equity.

The order of classification sought to be reviewed is therefore clearly discriminatory and inequitable and violates the Bankruptcy Act as well as the due process and equal protection clause of the Federal Constitution.

POINT C.

The subordination agreement contained in all the COABs which were exchanged for CDCs, whether in the hands of the original CDC holders or transferees, is void and unenforcible as a matter of contract law since it was obtained through fraud and misrepresentation and no additional consideration was given therefor. It necessarily follows that any distinction between original and other holders of COABs which were received in exchange for CDCs violates the Bankruptcy Act as well as the rights of the petitioners under the Federal Constitution.*

The relationship between debtor and creditor is a contractual relationship under either an express or implied contract and such contract is subject to the rules of law governing contracts.

It is a fundamental principle of the law of contracts that if rights are conferred upon one party there must be a consideration passing to the other party, or such rights are not enforceable in law.

It must be emphasized that the proposition now being considered does not in itself involve the question of fraud in any way, nor the question of whether the transfer of a security which was exchanged through fraud carries with it the assignor's right to bring a rescission action against the person committing the fraud, by the assignee. The question now being considered is solely a question of the law of contracts.

It must be remembered that the District Court assumed in appellants' favor, or the purpose of ruling only on certain limited issues, that the conversion privileges in the CDC's were illegal or, even if valid, were improperly

*This argument, of course, applies only to the COAB's which were received in exchange for CDC's whether in the hands of original holders or not, which it is estimated amounted to 30 to 32 million dollars principal amount.

exercised. The exchange of CDC's for COAB's were, therefore, obtained through fraud or mistake of fact. In any event, no consideration passed from the Debtor to the creditor, who was a general unsubordinated creditor of the Debtor at the time (CDC holder), for the agreement contained subsequently in the COAB by the same creditor to subordinate his debt to the debts owed to other classes of creditors.

Had the Debtor a legal right to convert the CDC's at the time into Preferred or Preference Stock and the Debtor waived such right, there would possibly have been a consideration for such a subordination agreement by the former CDC holders. But, on the contrary, it must be assumed in this case, to wit, that the Debtor had no such right of conversion or could not exercise it.

It is elementary that there must be a consideration to make any contract binding and enforceable in law.

> "The actual consideration for a contract cannot be waived." *Geger* v. *Kalmar Pack & Abrams Consol., Inc.,* 104 Misc. 85-90.
>
> "Were those obligated to consider the nature of this instrument? If it has no consideration to uphold it, it must be treated *nudum pactum.*" *Mendel* v. *Pickhell,* 37 Misc. 813-814.
>
> "It is of course unquestionable that no action may be maintained to enforce a gratuitous promise, however worthy the object to be promoted. The performance of such a promise rests wholly on the will of the person making it. He can refuse to perform and his legal right to do so cannot be disputed * * *." *Presb. Church of Albany* v. *Cooper, et al.,* 112 N. Y. 517-520.

At the time each CDC was exchanged for a COAB through the fraud or misrepresentation of the Debtor,

the Debtor, AGECO, was indebted at the time in the same amount to the holder of the CDC previously.

As stated in the case of *Arend* v. *Emith*, 151 N. Y. 502:

> "No consideration can arise simply from the method of doing an act which it is one's duty to do."

It is also stated in the same case by Vann, *J.*:

> "No consideration can arise simply from the method of doing an act which it is our duty to do. * * * It is a principle of common law from the earliest times that a promise without legal consideration as an equivalent cannot be enforced and that it is well settled 'the performance of an act which the party is under an obligation perform cannot constitute a consideration for a new contract'.
>
> Doing what they were already bound to do furnished no consideration for the promise * * *. The former parted with nothing of their own and the latter gained nothing." *Tolhurst* v. *Powers*, 122 N. Y. 460.

The subordination clause, therefore, in the COAB's which were exchanged for CDC's has no binding effect and is unenforceable in the hands of the original holder or any subsequent transferees.

The holders of the COAB's received nothing in return for their debt being subordinated to any other debt. The subordination clauses in such COAB's which were exchanged for CDC's are mere assertions on the part of the Company and are of no legal effect.

If the agreement to subordinate was void and unenforcible in its inception, against the original holder of the instrument, it is void and unenforcible in the hands

of all subsequent holders or transferees, as a matter of law. The subordination agreement could not be revived simply because of its subsequent transfer. It does not matter in the slightest whether the assignee or transferee of the security knew of the fraud or whether he purchased the security with knowledge that a subordination agreement was printed on its face.

In *In re Aktiebolaget Krueger & Toll*, 96 F. (2d) 768, the Court held that the provision of the Bankruptcy Act that dividends of an equal percentum shall be declared and paid on all allowed claims except such as have priority or are secured means that dividends paid to creditors shall be *pro rata* except where there is a priority given by law or by lawful contractual arrangement between the parties.

In the *Krueger & Toll* case, *supra*, the corporation issued a participating debenture subordinate as to the payment of principal to other debts of the corporation, but by the terms of these debentures the holders received a right to participate in the profits of the corporation in addition to specified interest in return for surrendering their equal right to repayment of principal with said creditors of the corporation. There was a consideration for the surrender of this right and a binding contract entered into between the corporation and these creditors. The decision is based on the proposition that the creditors contracted to subordinate their claims in a written contract which was binding on them and which contained a valuable consideration passing to those creditors. It was because they had a binding contractual arrangement containing a subordination clause that the Court held this clause enforceable.

There being no binding contract to subordinate between the holders of the CDC's who had exchanged them for COAB's and the Debtor, AGECO, there is, therefore, no enforceable subordination clause in the case at bar and the *Krueger & Toll* decision, *supra*, is not applicable.

The holders of COAB's are not estopped from asserting the invalidity of the subordination agreement in the COAB's.

See:

Thomson v. *Simpson,* 128 N. Y. 270;
New York Rubber Company v. *Rothery,* 107 N. Y. 310;
Rothschild v. *Title Guarantee & Trust Company,* 204 N. Y. 458;
Andrew v. *Cohen,* 221 N. Y. 148;
Ruggles v. *Ormrod,* 198 N. Y. 119.

Conversion and subordination clauses in COAB's are no integral part of a security. They must be construed as separate agreements, and, therefore, unenforceable unless there is consideration received by the holders to support them.

In speaking of a conversion clause in a security, the Court in the following case says:

> "This contract, although appearing on the face of the indenture, is in fact a separate independent agreement. It has no part of the bond proper. Its purpose is not to secure the payment of money. Its presence does not affect the negotiability of the bond. Its validity would not impair the liability of the obligor to discharge the debt. It gains nothing in force by reason of its association with the stipulations of the bond. It must be construed as though embodied in a separate writing." *Lisman* v. *Milwaukee, L. S. & W. Ry. Co.,* 161 F. 472-475.

The agreement to subordinate, even if valid otherwise, is not enforcible as to those COABs which were exchanged for CDCs, whether they are in the hands of original hold-

ers or not, since such an agreement must be construed as *nudum pactum,* void in its inception. Hence the distinction made by the order of classification, confirmed by the Circuit Court of Appeals, between original and other holders of COABs which were exchanged for CDCs, is inequitable and discriminatory and brings this cause within the scope of the due process and equal protection clause as defined by this Honorable Court.

POINT D.

The Circuit Court of Appeals erred in holding the subordination agreement contained in the COABs valid and enforcible in bankruptcy.

The order of classification affirmed by the Circuit Court of Appeals, which held that the COABs were subordinate to the Fixed Interest Debentures of AGECO and bars therefrom participation in the Plan of Compromise and Reorganization of AGECO violates the Bankruptcy Act as well as the equal protection of the laws guaranteed by the Federal Constitution.

The COABs by their terms were specifically not made subordinate to any issue of CDCs or 5½% CICs (a Fixed Interest Debenture of AGECO). Under Section 65 (a) of the Bankruptcy Act (11 U. S. C. A. 105 [a]) they must participate on a parity and to the same extent as the CICs or CDCs in the funds and reorganization of AGECO. Both the CICs and CDCs do participate in the approved Plan of Compromise and Reorganization of AGECO. It is submitted by the petitioners-appellants that the subordination clause contained in the COABs is inconsistent, ambiguous and therefore void.

At the hearings before the Special Master petitioners-appellants raised the contention that the subordination clause contained in the COABs must be interpreted to

mean that the COABs are *not* subordinate to any issue of CDCs, in view of the fact that the CDCs were by their terms convertible into stock of the company at the *option* of the *company.*

The terms of the CDCs distinctly state they were convertible into stock of the company at the option of the company (676).

The subordination clause contained in all of the COABs reads as follows:

> "It is the intent hereto that this obligation and all other obligations of this issue shall be subordinate to the following (hereinafter called 'senior obligations'), namely: All bonds, debentures and other indebtedness of the company and of any successor corporation, now or hereafter created and outstanding, except
>
> 1. The obligations of this issue, and
>
> 2. Indebtedness or obligations convertible at the option of the company into stock of the company of any class or subordinated by their terms to other indebtedness or obligations of the company; * * *." (511-512).

The Special Master found in his report that the interpretation urged by the petitioners was correct, and said:

> "The subordination clause may be read, and I so read it, as subordinating the COs to Bonds but not to Convertible Debenture Certificates" (676).

The Fixed Interest Debentures of AGECO, which were considered by the District Court in the Plan of Compromise and Reorganization as senior indebtedness prior in rank to the COABs, amount to approximately $59,000,000. Among the outstanding FID debt are the 5½% CICs due

1938 amounting to the principal sum of $1,260,000. This issue of CICs, secured by an indenture trust, was considered unsubordinated general debt of AGECO and participates fully in the funds and reorganization of AGECO as senior debt.

The Convertible Investment Certificates mentioned above all contain the following provision:

> "This Investment Certificate may, at the option of the Company at any time after, but not before, November 15, 1933 (if the Company is not then in default in the payment of dividends upon its $5.50 Dividend Series Preferred Stock), by notice mailed * * * to be converted into fully paid and non-assessable shares, without par value, of the $5.50 Dividend Series Preferred Stock of the Company, on the basis of one share of such Preferred Stock for each $100 principal amount hereof. * * * The mailing by the Company, as above provided, of notice of conversion, shall *ipso facto* operate as conversion of this Investment Certificate on the date of conversion fixed in such notice, into shares of said $5.50 Dividend Series Preferred Stock of the Company upon the basis hereinabove stated (subject to the right of the holder hereof, as aforesaid, to convert the same on or prior to the date of conversion fixed in such notice, into either shares of stock of Eastern Utilities Investing Corporation or 5% convertible debenture bonds of the Company) * * * " (575).

It clearly appears that the CICs by their terms were convertible at the option of the Company into preferred stock, and hence the COABs are not subordinate to any CICs as well as to any CDCs since both the CICs and CDCs are indebtedness or obligations convertible at the option of the Company into stock and therefore came

within the exceptions contained in the COAB subordination clause.

Regardless of the question of whether the act of conversion, purportedly made by AGECO in May 1932, was valid or not, which was assumed in appellant's favor by the District Court, the Special Master nevertheless found that the 1931 series of CDCs could not have been legally converted due to time limitations, and found that the said CDCs were unsubordinated general debt of AGECO (Special Master's Conclusions of Law 7, 8; fol. 788).

The COABs are specifically, by their terms, on a parity with the CICs and the CDCs which participate in the Plan of Compromise and Reorganization of AGECO.

Section 65 (a) of the Bankruptcy Act (11 U. S. C. A. 105 [a]) provides "dividends of an equal percentum shall be declared and paid on all allowed claims except such as have priority or are secured."

Section 65 (a) above establishes an inexorable rule for distribution of funds, to wit, that creditors' claims which are of the same class or equal in rank to another class, must receive the same *pro rata* dividends which claims of the same or equal class receive. Under Section 65 (a), petitioners submit, the COABs must receive the same share as CDCs or CICs of 1938 in the Plan of Compromise and Reorganization of AGECO.

In the *Krueger & Toll* case, *supra,* the Court held, subdivision (a) of this section means dividends paid to creditors shall be *pro rata* except where there is a priority given by law or by lawful contractual arrangement between the parties. Inasmuch as in the instant case the COABs are on a parity with the CICs and CDCs no priority or preference can be given to the CICs or the CDCs and the *Krueger & Toll* case, above, is not authority for any other finding.

The contention raised by petitioners that the subordination clause contained in the COABs was inconsistent

and void was discussed by the Special Master in his report. The Special Master, in his report, asked (676-677)

> "If they share in this fund on a parity with CDCs to any extent, what becomes of that part of the instrument which subordinates them to bonds?"

The same argument, of course, applied to the CICs, a Fixed Interest Debenture, but this fact was not discovered or known at the time the hearing took place before the Special Master.

In turn appellants ask if they do not share in this fund on a parity with the CICs and the CDCs which are both unsubordinated general debt of AGECO, what becomes of that portion of the instrument which specifically states they are not subordinate to CICs or to any issue of CDCs?

Is the effect of any other conclusion or result not tantamount to a finding that they are subordinate to the CICs of 1938 and the CDCs?

Was it the intent that under certain conditions or events that the CICs and CDCs should share in the estate but that the COABs should not? If such was the intention, should it not have been clearly stated or indicated in the instrument?

It cannot be denied that the COABs are not subordinate to the CICs of 1938, a Fixed Interest Debenture and general unsubordinated creditor. The Special Master also found that CDCs which are valid and outstanding are unsubordinated general creditors of AGECO (Sp. M. Concl. of Law, fols. 7 and 8; fol. 788).

The Special Master's Report attempted to avoid this inconsistency by stating (fol. 677) that COABs cannot take anything which should go to the bonds because these have first call and cited *Bird & Sons Sales Corp.* v. *Tobin*, 78 F. (2d) 371.

The analogy drawn between *Bird & Sons Sales Corp.* v. *Tobin* and the instant case is not in point.

The case of *Bird & Sons Sales Corp.* v. *Tobin* follows and cites the cases of:

> *Searles* v. *Mechanics Loan & Trust Company,* 249 F. 942; and
> *In re George P. Schingel & Sons, Inc.,* 16 F. (2d) 289.

All of these cases held that where a debtor is insolvent or bankrupt and one group of creditors agrees to extend credit to the bankrupt or debtor in order to continue the business for the benefit of all creditors, the agreement between one group of creditors to subordinate their old debt to the new debt is enforceable.

It will be noted that in the case of *Bird & Sons Sales Corp.* v. *Tobin* the creditors whose claims were held to be subordinate agreed in writing to subordinate their claims to induce the other creditors to extend the additional credit to the debtor. In reliance thereon, the new creditors advanced funds to the debtor enriching the debtor's estate which benefited the subordinated creditors. In other words, a consideration flowed from one group of creditors to another.

In the instant case, as distinguished from *Bird & Sons Sales Corp.* v. *Tobin* case, the old creditors are the bonded fixed interest debenture holders and CDC holders of AGECO whose claims arose in the debtor estate prior to the authorization or issuance of COABs.

The creditors who extended new funds to the debtor estate were the COABs. Most of the COABs were issued in exchange for CDCs, which has been held to be unsubordinated debt of AGECO, and many COABs were issued in the first instance for cash or in exchange for se-

curities of other companies (Sp. M. Find. of Fact 45; fol. 765).

The funds and estate of the debtor were accordingly enlarged and enriched and the bond and fixed interest obligations of AGECO benefited accordingly.

There was no agreement ever made between the holders of COABs or any other class of creditors of AGECO as in the *Bird & Sons Sales Corp.* v. *Tobin* case or *Searles* v. *Mechanics Loan & Trust Company,* and *In re George P. Schingel & Sons, Inc.* cases.

It cannot be said that if the COABs share on a parity with the CICs of 1938 and with the CDCs and hence with the general unsubordinated creditors of AGECO, that the other general creditors were prejudiced as in the *Bird & Sons Sales Corp.* v. *Tobin* case.

The participation of COABs in the reorganization or liquidation of AGECO will decrease the estate or fund of AGECO to a much lesser extent than that by which it was enriched and enlarged by the original issuance of COABs.

The District Court has stated that it was the intention in insolvency that the COs were not to receive anything until the bonds or Fixed Interest Obligations were paid in full.

The intention is also clearly and unequivocally expressed in the COABs that the COABs are not to be subordinated to any indebtedness which is convertible at the option of the Company into stock of the Company. This includes, as shown previously, all the CICs of 1938, whether extended or otherwise, and all of the CDCs which are valid and outstanding. Nowhere does there appear any provision or even suggestion that these other classes of debt, to wit, CICs of 1938 or CDCs which are on a parity with the COABs, may participate in the event of insolvency or in bankruptcy, as a general creditor, but that the COABs may not.

On the contrary the intent is clear that whatever the CICs of 1938 or the CDCs receive, the COABs must receive, since they are on a parity and not subordinate to said securities. The theory, expressed by the Trustee and adopted by the lower Court, of taking the share which the COABs would ordinarily receive and then turning over such dividend or participation to the debenture holders and other general creditors to whom it is stated the COABs had agreed to subordinate their claims, is clearly fallacious contrary to the provisions and terms contained in the COABs. The answer simply is that at all times the COABs have a right to ask what share did the CICs of 1938 and CDCs receive? We must receive the same as our agreement specifically says so. Our contract says we are not subordinate to them. It is obvious, therefore, that this method of reasoning can be carried into a complete circle.

The *Krueger & Toll* case *supra* has no application with respect to the instant case. The facts there were different. There were two classes of creditors and one clearly agreed to be subordinate to the other in return for a good consideration. The petitioners herein do not controvert the proposition of law stated by the *Krueger & Toll* case, to wit, that creditors may contract to subordinate their claims in a written contract which is binding upon them if a valuable consideration passed to those creditors, but the facts in this case are entirely different. Here the subordination clause in question clearly states that the COABs are not to be subordinate in any event to the CICs of 1938 and the CDCs, and that the COABs are on a parity with them, and those two latter classes of creditors are participating in the funds of the Debtor estate as General Creditors.

It is for this reason that the appellants contend that the subordination clause in the instant case is inconsistent, ambiguous and invalid, and therefore void.

Certainly, the subordination clause must be strictly construed according to its terms and the inconsistency or ambiguity resolved against the maker of the instrument—in this case AGECO.

Since AGECO is a domestic corporation, organized under the laws of the State of New York the rules of construction of New York State must apply.

It is well settled law in New York State that the rule of strict construction must be applied against the party responsible for the ambiguity or inconsistency.

In *Halpern, Davidoff & Sack* v. *Amtorg Trading Corp.*, Law Journal, March 17, 1943, App. Div. 1st Dept. the Court said:

> "The contract was drawn by plaintiffs. Therefore, any uncertainty or ambiguity of language, such as that which affects the date of the contract's termination, must be resolved most strongly against them, for they were the persons who used it."

In the case of *Gillett* v. *Bank of America*, 160 N. Y. 549, the Court at page 555 said:

> "The reason of the rule that the language of an instrument is to be construed against the person who proposes it rather than against the person who is invited to accept it, is that men are supposed to take care of themselves, and that he who chooses the words by which a right is given, ought to be held to the strict interpretation of them rather than he who only accepts them."

It is respectfully submitted that the Circuit Court of Appeals erred in holding the subordination agreement contained in the COABs valid and enforcible in Bankruptcy.

CONCLUSION.

It is therefore respectfully submitted that this case is one calling for the exercise by this court of its supervisory powers, by granting a writ of certiorari and thereafter reviewing and reversing said decision.

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